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Testimony

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THE U.S. CUSTOMS SERVICE'S EFFORTS TO
ENFORCE IMPORT LAWS AND REGULATIONS

STATEMENT OF
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BEFORE THE
SENATE COMMITTEE ON FINANCE



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SUMMARY OF STATEMENT

GAO discusses Customs' ability to enforce laws and regulations governing imports. It summarizes three reports concerning the adequacy of Customs' cargo examination process, the ability of Customs to protect intellectual property rights, and the role of import specialists in entry processing.

Cargo Examinations

Customs relies on physical examinations of imported merchandise as the primary means for ensuring compliance with U.S. trade laws. We found that the manner in which physical examinations of import shipments are conducted at the New York Seaport and John F. Kennedy Airport does not ensure that importers are complying with importation laws and regulations. We found similar conditions at other ports of entry where Customs has instituted innovative techniques for cargo inspection. In addition, the manner in which examinations are performed does not provide reliable information for determining whether similar shipments should be examined in the future. To improve the quality of examinations and to better ensure importers' compliance, inspectors need policy and procedures that establish criteria for basing the intensity of examinations on the potential risks of the shipments and purposes of the examinations.

Protection of Intellectual Property

GAO surveyed firms that enlisted Customs' assistance in protecting their intellectual property rights (i.e., patents, trademarks, and copyrights) from foreign infringement. Many of the responding firms indicated that imports of goods that counterfeit or infringed the intellectual property rights protected by Customs continued to enter the country. Respondents added that these imports damaged their sales and consumer confidence in their products. They suggested that, to enhance Customs' efforts to protect intellectual property rights, (1) the ITC be authorized to direct Customs to seize goods and cause them to be forfeited when enforcing exclusion orders, (2) Customs shorten the 2 to 3 months it takes to inform the ports of a newly recorded trademark or copyright, and (3) Customs intensify its efforts to enlist the support of intellectual property rights owners in identifying shipments containing counterfeit or infringing goods.

The Role of Import Specialists

Like Customs inspectors, import specialists have a major role in protecting revenue and enforcing import laws. GAO's March 1985 report concluded that most entries submitted to Customs and reviewed by import specialists at the New York Seaport and Los Angeles District were correct. When changes were made, the amount additionally assessed was slightly more than the amount refunded to the importer.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of reviews we have conducted regarding the U.S. Customs Service's efforts to enforce laws and regulations governing imports. I will focus my remarks today on the adequacy of Customs' cargo examination process, Customs' efforts to protect intellectual property rights, and the role of Customs' import specialists. I would like to begin by discussing the quality of Customs' cargo examinations.

CARGO EXAMINATIONS

In September 1986, we issued a report based on work we performed at the request of Senator Alphonse D'Amato on how well the Customs Service examines cargo entering the United States. The report--
Cargo Imports: Customs Need to Better Assure Compliance With Trade Laws and Regulations (GAO/GGD-86-136)--concluded that the manner in which Customs inspectors conduct physical examinations of cargo does not ensure compliance with trade laws and regulations.

Although our review primarily focused on the New York Seaport and the John F. Kennedy (JFK) Airport, it appears likely that the quality of Customs' examinations at seven other ports we visited is similar to that in New York. It is important to note that some of these ports use automated systems for keeping track of imports, selectivity systems for identifying high-risk shipments, and centralized examination stations. Customs believes that these initiatives have resulted in a more cost effective, efficient, and

thorough cargo examination and are enabling it to handle the increasing workload.

Background

The Customs Service is responsible for ensuring that imported merchandise complies with the trade laws of the United States. Customs relies on physical examinations of the merchandise by inspectors as the primary means of ensuring compliance. About 4,300 Customs inspectors are responsible for enforcing over 400 provisions of law at over 300 ports of entry. During fiscal year 1986, these inspectors were responsible for ensuring that 7.3 million shipments (an increase of 67 percent over fiscal year 1979) were in compliance with the import requirements. Most of the merchandise enters the United States in containers transported by jumbo jets, cargo ships, or tractor trailers entering at land border ports. These containers can be 20 to 40 feet long and may hold thousands of packages.

We observed inspectors and special teams examining cargo for 5 days at three representative inspection sites at the New York Seaport and three at the JFK Airport between November 1985 and January 1986. We also made a limited number of observation at inspection sites at seven other ports during April 1986 to determine whether the practices for physically examining cargo were similar to those in New York. The ports were Los Angeles, California; Atlanta and

Savannah, Georgia; Laredo and Houston, Texas; and Blaine and Seattle, Washington.

Observations of Cargo Examinations

We observed 635 examinations at the New York sites and 234 at the seven other ports of entry. We believe the process for examining cargo is superficial and cannot ensure that importers are complying with import laws and regulations. Regardless of the reason for examining the cargo or the size of the shipment, the inspectors

- usually examined one or two packages selected from the most accessible locations in the shipment,
- often allowed non-Customs employees to select merchandise to be examined, and
- usually did not verify that the quantity in the shipment was equal to the amount declared by the importer.

Since 1981, Customs has used a selective inspections system which enables the inspectors to physically examine shipments identified as high risk (i.e. those most likely to involve violations); the remaining shipments are released without physical examination. According to Customs officials, about 20 percent of the shipments are selected for a physical examination. Shipments are identified as high risk if, among other things, (1) inspectors have not previously processed merchandise from the importer and do not have sufficient information to determine the extent of the importer's voluntary compliance or (2) the shipment is suspected

of one or more violations such as exceeding prescribed quotas or not adhering to trademark or copyright regulations. Shipments are also randomly selected to guarantee that every importer and commodity are examined at intervals to ensure the integrity of the selective process.

The reasons the inspectors were given for performing the examinations did not seem to affect how the examinations were conducted. We observed that inspectors usually did not seek full access to cargo shipments and examined only a few packages of the most accessible merchandise in a given shipment. Even where all cargo was fully accessible, inspectors usually examined the most conveniently located merchandise. For example, for 211 examinations at the New York Seaport, the inspectors did not have full access to the cargo; i.e., part of the merchandise would have to be moved in order to examine other parts of the shipment. For 158 (75 percent) of these 211 examinations, the inspectors selected the packages most accessible and did not request that the merchandise be moved for greater access. In 92 percent of the examinations we observed at the JFK Airport and 86 percent at the New York Seaport for which the shipments contained more than 10 packages, the inspectors examined no more than 2 packages or items. At JFK Airport, we also observed that non-Customs employees, such as warehouse workers or carrier representatives, were allowed to select the specific packages to be examined.

Inspectors are required to ascertain whether the quantities of merchandise entering the country agree with those shown on the invoices in order to help protect revenue and to enforce quota requirements. In 194 of the 289 examinations we observed at the New York Seaport and 277 of the 346 examinations we observed at JFK Airport, inspectors did not count, weigh, or estimate the merchandise quantities.

We also observed Customs' special enforcement teams which are established to ferret out narcotics violations and commercial fraud. These teams generally selected the merchandise to be examined from various parts of the shipment and opened more packages in the shipment, but they examined far fewer shipments than did the other inspectors.

Customs Selectivity System

Customs' selectivity system is intended to identify high-risk shipments for physical examinations. The remaining shipments are released without physical examinations. We agree with Customs' initiative to improve cargo processing by using a selectivity system, but whether it will enhance importer compliance with trade laws depends on the thoroughness of Customs' physical examinations. The results of these examinations and other sources provide Customs with the basis for selecting which shipments to physically examine in the future and which to release without physical examinations.

To illustrate, Customs examines shipments by first-time importers because it lacks sufficient information to determine whether the importers voluntarily comply with U.S. trade requirements. We observed 177 examinations of first-time importers with an average shipment size of 318 packages or items at the New York sites. In 64 percent of these examinations, the inspectors examined at most only one package. Once the first-time importer's shipment is physically examined, future shipments by the same importer are selected from time to time for physical examination to evaluate the integrity of the importer. These random examinations are performed in the same manner as the other examination. In 24, or 73 percent, of the 33 random examinations we observed, the packages selected for examination were at the rear door of a container or at the top of a stack of packages.

Inspectors Need Better Guidance

The high volume of merchandise requiring examination, the need to keep commerce moving, and the lack of specific guidelines for inspectors to follow have reduced the quality of Customs' examinations. We recommended that Customs develop specific policy and procedures for inspectors to use for determining the intensity of cargo examinations. The degree of intensity should be based on the risk of the shipment and the purpose of the examination. In commenting on our report, Customs stated that the new initiatives it has underway, including the selectivity system and centralized examination facilities, should relieve the

problems we identified. Whether these and other initiatives will enhance Customs' assurance of importer compliance with trade laws, however, depends on the thoroughness of Customs' physical examinations.

CUSTOMS SERVICE PROTECTION OF INTELLECTUAL PROPERTY RIGHTS

In our May 1986 report on Customs' protection of intellectual property rights--International Trade: U.S. Firms' Views on Customs' Protection of Intellectual Property Rights (GAO/NSIAD-86-96)--we provide the results of a survey we conducted to obtain the perspectives of firms that have sought Customs Service assistance to protect their intellectual property rights from counterfeit and infringing imports. We released this report to the Subcommittee in May 1986.

Background

Protection of intellectual property rights against counterfeit and infringing imports is one of the Customs Service's many responsibilities. Firms use two separate methods to obtain Customs' assistance in protecting intellectual property rights.

1. Recordation: Owners of trademarks and copyrights that have previously been registered with the federal government can record such rights directly with the Customs Service for a fee of \$190. In protecting trademarks and copyrights, Customs can exclude shipments of counterfeit or infringing

goods from entering the country and, in certain instances, can seize such shipments, which may be forfeited to the government. Customs officials estimate that they are currently responsible for protecting 7,000 to 8,000 trademarks and copyrights.

2. Section 337 exclusion orders: Owners of other types of intellectual property rights, most notably patents, who want Customs' assistance must first obtain exclusion orders from the International Trade Commission. To obtain such an order, the owner must participate in a year-long (18 months in "complicated" cases) adversarial proceeding under section 337 of the Tariff Act of 1930 (19 U.S.C. 1337) in which the owner must demonstrate, among other things, that a valid and enforceable intellectual property right has been infringed by imports. Should the Commission find in favor of the firm bringing the complaint, it can, among other things, instruct the Customs Service to exclude counterfeit and/or infringing goods from entering the country. Exclusion orders give Customs the authority to exclude, but not seize, shipments of goods that counterfeit or infringe the intellectual property rights covered by the orders. As of April 1985, Customs was responsible for enforcing 43 exclusion orders.

We conducted separate surveys of firms that have used each method. To obtain the perspectives of firms on the Customs

Service's ability to stop imports of goods that counterfeit or infringe trademarks and copyrights, we surveyed firms that had recorded such rights with Customs from January 1, 1980 to April 10, 1985. Our universe included all firms, or their outside legal counsels, that had recorded trademarks or copyrights with Customs and alleged that the rights were being infringed at the time of the recordation. To obtain the perspectives of firms on Customs' ability to enforce section 337 exclusion orders, we surveyed firms that had obtained exclusion orders in section 337 proceedings initiated since January 1975.¹ Our universe included all firms that had obtained exclusion orders to protect intellectual property rights in cases starting January 1, 1975, with all litigation concluded as of April 25, 1985.

Customs Not Stopping
Counterfeit/Infringing Goods

The majority of respondents to our surveys reported that counterfeit and infringing goods continued to enter the country after they had enlisted the assistance of the Customs Service, causing appreciable losses in sales and in consumer confidence in their products. However, the large majority of firms that provided assistance to Customs, usually information on incoming shipments containing counterfeit or infringing goods, reported

¹This survey was part of a larger effort that also addressed many aspects of the International Trade Commission's administration of section 337 proceedings.

that they were satisfied with Customs' response to the information provided.

Given the relatively small fee for recording registered trademarks or copyrights with the Customs Service, a number of the respondents to our survey on Customs' recordation system indicated that they did not have high expectations regarding Customs' ability to protect these rights. The following comment received from one survey respondents typifies this opinion.

"In view of the huge task facing Customs and since the relative expense [of a] client's using Customs is not substantial, anything which Customs can perform to help a client is considered . . . of substantial benefit.

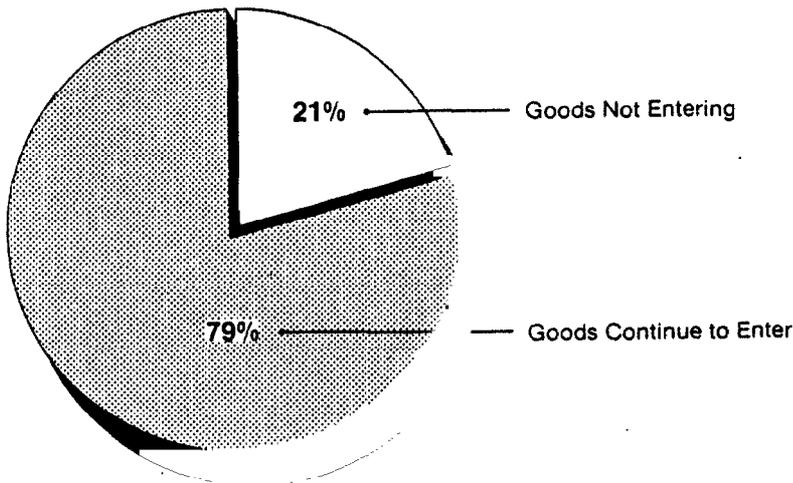
As shown in figure 1, of the firms responding to our survey on Customs' recordation system, nearly 80 percent of those that indicated they had a basis to judge reported that counterfeit and infringing goods continued to enter the country after recordation. Of these firms, over half reported that the value of counterfeit and infringing imports at least remained the same, with about 31 percent of them stating that the level actually increased. About 87 percent of the firms indicating that counterfeit and infringing goods continued to enter the country reported that the counterfeit and infringing goods did at least some damage to sales, with 60 percent characterizing the loss in sales as moderate to very great. Survey respondents valued the sales losses caused by these imports at less than \$100,000 to \$15 million. Similarly, about 78 percent of these firms reported

that infringing imports appreciably damaged consumer confidence in their products.

Figure 1: Selected Responses From Recordation Survey^a

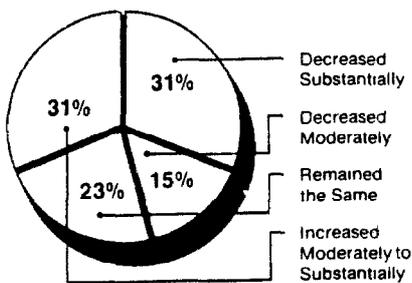
Firms responding to the survey

Imports entering after recordation?

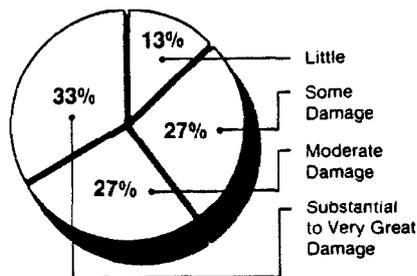


Firms indicating that counterfeit/infringing goods continued to enter country after recordation^b

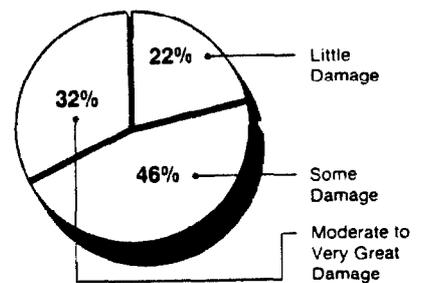
Value of Counterfeit/
infringing goods



Damage to sales



Damage to consumer confidence



^aFigures do not include those firms indicating that they had no basis to judge.

^bFigures represent those respondents indicating that goods continued to enter the country (see shaded area in the first pie chart).

Firms initiating section 337 proceedings do so with the objective that, should they win, the exclusion orders will effectively stop the counterfeit and/or infringing goods from entering the country. The president of one such company characterized an exclusion order as a "wall around the country." The high cost of litigating section 337 cases--generally between \$100,000 and \$1 million, with a few costing over \$2.5 million--contributes to this expectation.

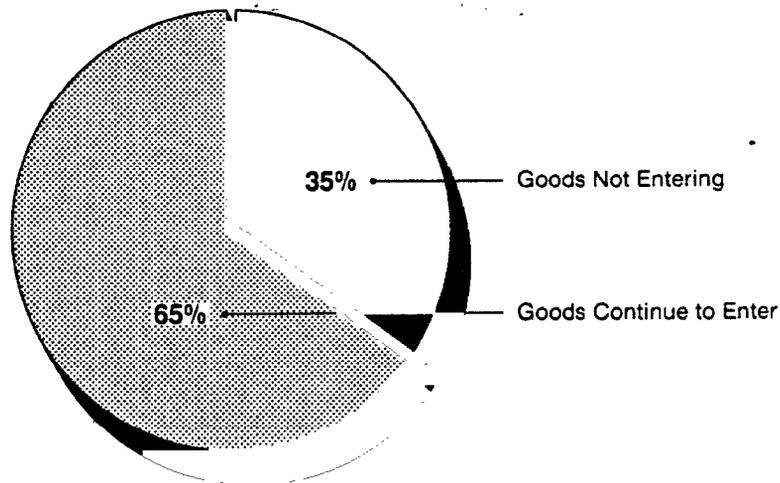
Although some firms voluntarily stop importing counterfeit or infringing goods covered by exclusion orders, others ignore the orders, placing the enforcement burden on Customs' port inspectors. An exclusion order often is not an effective deterrent to importing such goods, since Customs cannot seize these goods. Foreign infringers who have shipments stopped by Customs are required only to re-export the goods and, thus, lose only the shipping charges. Indeed, foreign infringers have been known to "port shop," that is, ship the counterfeit or infringing goods from port to port until they gain entry. We also understand that foreign infringers sometimes repackage the goods that are returned to the country of origin and attempt to export them to the United States at a later date. A number of knowledgeable business officials commented that protection of intellectual property is uneven from port to port.

As shown in figure 2, of the survey respondents who indicated they had a basis to judge, over 65 percent reported that counterfeit and infringing goods covered by the exclusion orders continued to enter the country after the orders were issued. About 71 percent of these firms reported substantial decreases in the value of such imports, in some cases due to the willingness of importers to voluntarily abide by the International Trade Commission determinations. Approximately 29 percent reported little change. About 73 percent of the firms indicating that imports of counterfeit and infringing goods continued to enter the country reported that these imports damaged their sales to at least some extent, with about 46 percent of them stating that their sales were hurt to a moderate or substantial extent. Survey respondents valued the sales losses caused by these imports from less than \$100,000 to \$5 million. Company officials told us that the continued presence of illegitimate goods in the domestic marketplace, sometimes in a form virtually indistinguishable from the original, also caused consumers to lose confidence in the authentic products.

Figure 2: Selected responses From Section 337 Surveya,b

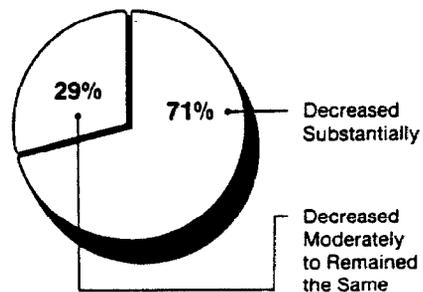
Firms responding to the survey

Imports entering after exclusion order?

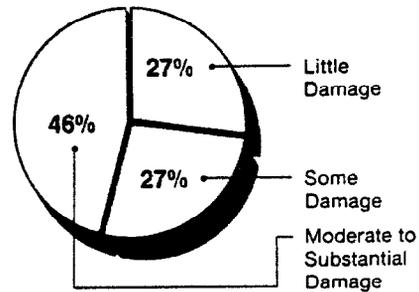


Firms indicating that counterfeit/infringing goods continued to enter the country after issuance of exclusion orders^c

Value of counterfeit/infringing goods



Damage to sales



^aFigures do not include firms indicating they had no basis to judge.

^bThe level of damage to consumer confidence in the product was not assessed in this survey.

^cFigures represent those firms responding that goods continued to enter the country (see shaded area in first pie chart).

Several firms complained that Customs' inability to enforce their exclusion orders undermined the effectiveness of section 337 as a trade remedy. One firm commented that:

"There was no [Customs] enforcement whatsoever . . . [For] the time and money involved for a small firm like ours, the end result was of little benefit because of the lack of enforcement by the Customs Service."

Another stated that:

"[W]e believe that the efforts and money expended to obtain the exclusion ruling from the [International Trade Commission] . . . certainly did not provide the protection we expected."

Because of the lack of enforcement and high cost, firms commented that they would not use section 337 again to deal with imports of other types of counterfeit or infringing products. One stated that:

"There are now many of our products being copied identically. Because of the cost of the [International Trade Commission] case and the lack of enforcement by Customs it doesn't seem fruitful to take these other items to the [Commission]. Yet, we are being hurt and sales are suffering and people are being laid off."

Customs' performance reportedly improves when it is assisted by the owner of the intellectual property right. Over 25 percent of the firms receiving exclusion orders and 35 percent of the firms that had recorded trademarks and copyrights undertook independent investigations and provided the results to Customs. Such information could include the names of companies importing counterfeit or infringing goods or information on particular shipments of such goods. Nearly 80 percent of the firms that provided information to Customs and expressed an opinion were satisfied with Customs' response to the information provided. One firm commented that:

"Customs is most cooperative and efficient when placed on notice. However, their ability to spot infringing or counterfeit goods without notice is extremely erratic."

Another stated that:

"Customs usually must be informed and prodded to be effective, however, once informed and prodded, Customs is helpful."

Survey Respondents Point to Staff
Limitations As Foremost Problem

Respondents to both surveys expressed high regard for the work of port inspectors and generally noted the competence and helpfulness of port personnel. Reflecting these comments, one firm stated that it has "been impressed with the cooperative spirit and willingness to help exhibited by the Customs Service personnel."

Respondents' comments pointed to staffing as the primary limitation on Customs' ability to protect intellectual property rights. One firm wrote that "individuals at the Customs service are most cooperative . . . but shortage of manpower has resulted in less than satisfactory results overall." Another stated that "it appears that the Customs Service may do what it can but with current staffing and funding . . . it is difficult for Customs to remember and intercept infringing goods." Still another recommended that "we need more trained import specialists at ports of entry; need more trained inspectors at the major ports." Finally, one firm commented that "the only impediment to even

better enforcement of the laws by Customs is the lack and shortage of personnel."

Survey Respondents Suggest Ways
to Strengthen Customs' Efforts

Survey respondents supported three proposals, two of which they volunteered, for enhancing the ability of Customs' present staff to protect U.S. intellectual property rights from counterfeit and infringing imports.

Over 90 percent of our survey respondents who expressed an opinion believed that authorizing the International Trade Commission to direct Customs to seize goods and cause them to be forfeited would improve Customs' ability to enforce section 337 exclusion orders. In our August 1986 report--International Trade: Strengthening Trade Law Protection of Intellectual Property Rights (GAO/NSIAD-86-150)--we recommended that Congress give the International Trade Commission such authority, which would be intended to strengthen the deterrent effect of the exclusion order. If such a proposal were to become law, infringers would not only face the prospect of losing shipping costs but also the possibility that Customs would seize and dispose of their entire shipments.

Several survey respondents suggested that Customs needs to shorten the 2 to 3 months it takes to inform the ports of a newly recorded trademark or copyright. A number of firms cited this

delay as a major problem. One stated that "In my experience, it takes about 2-3 months to register a [copyright] with Customs. That is too long . . . piratical copies slip by Customs." During this period, counterfeit and infringing goods may continue to enter the country even though the intellectual property right is legally protected from the time Customs approves the application for recordation. Until port inspectors are notified, they have no knowledge that they are to protect a particular trademark or copyright from infringing imports. In some cases, 3 months may constitute a significant portion of the entire market life of a product. Some consumer goods, such as those marketed in conjunction with newly released movies, have very short market lives.

The survey responses also indicated that Customs could improve its performance by intensifying its efforts to elicit the support of intellectual property rights owners in identifying shipments containing counterfeit or infringing goods. This could be accomplished by providing an informational brochure or similar document to firms obtaining Customs assistance. Under current procedures, there is no formal mechanism for firms initiating section 337 proceedings to obtain any information from Customs. Firms recording trademarks or copyrights with Customs receive only confirmation letters and copies of the notices sent to the ports. As a result, they may not have realistic expectations of Customs' abilities or appreciate the need to provide assistance.

ROLE OF CUSTOMS' IMPORT SPECIALISTS

Our March 1985 report--U.S. Customs Service: Import Specialists' Duties and Reviews of Entry Documentation (GAO/GGD-85-45)--was undertaken at the request of the Subcommittee on International Trade, Senate Committee on Finance. Import specialists are responsible for determining whether importers and/or their brokers have properly classified and valued imported products, correctly calculated duties owed, and provided all data and documents required to admit merchandise into the country. Classification of imported goods determines the tariff rate and is the basis for enforcing quota and other merchandise restrictions.

We analyzed the results of import specialists' reviews of entry documents to ensure that the importers or their brokers had properly classified the imported product, correctly calculated duties owed, and provided the required documents. Our review was conducted at two of the largest Customs' districts--New York Seaport and Los Angeles District.

We concluded that most of the import documentation submitted to Customs and reviewed by import specialists were determined to be error free. The import specialists in New York found errors in 7 percent of the entries they reviewed while the import specialist in Los Angeles discovered errors in 4 percent of the entries reviewed. We also reported that errors discovered by import

specialists in fiscal year 1983 affecting duties and taxes resulted in \$25 million in additional assessments compared to \$22 million in refunds to importers.

We were asked to perform this review because the Subcommittee was concerned that Customs was deemphasizing its commercial operations. As I mentioned earlier, the number of shipments entering the United States increased 67 percent between 1979 and 1986. In fiscal year 1986, Customs had 927 import specialists' positions to process the workload, or about 299 fewer than in fiscal year 1979. Customs states that it is not deemphasizing commercial operations but is able to reduce the number of import specialists through increased use of technology, automation, and increased selectivity.

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Mr. Chairman, this concludes my statement. I would be happy to respond to any questions you have at this time.